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No. 04-1371

Supreme Court, U.S.
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In The

Supreme Court of the United States

MERRILL LYNCH, PIERCE,
FENNER & SMITH, INC.,

Petitioner,

v.

SHADI DABIT, on behalf of himself
and all others similarly situated,

Respondent.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit**

BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

A. Introduction

This action arises out of an employers' breach of its fiduciary and contractual duties owed to its employees. Respondent Shadi Dabit ("Dabit" or "Respondent") is a former employee of Petitioner, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch" or "Petitioner"). Dabit was employed as a "Financial Associate," more commonly referred to as a broker. Dabit instituted this putative class action lawsuit on April 26, 2002, on the heels of a much publicized investigation conducted by the New York State Attorney General, Elliott Spitzer. The investigation found, among other things, that Merrill Lynch engaged in a systemic practice of issuing positive securities analysts' recommendations to attract and curry favor with investment banking clients and culminated in Merrill Lynch paying a $100 million fine. *See* First Amended Class Action Complaint. The Attorney General's investigation found that Merrill Lynch's analysts routinely publicly issued glowing recommendations for stocks in companies for which Merrill Lynch provided or aspired to provide investment banking services while privately believing that such stocks were poor investments. *Id.* As detailed in an Affidavit submitted by an Assistant Attorney General of the State of New York, Merrill Lynch withheld material information from its brokers about the stocks it was touting, including the fact that Merrill Lynch's analysts really thought that these stocks were, among other things, "crap," "shit," "piece[s] of junk," "dog[s]," or "going a lot lower." *Id.*

In his Amended Complaint, Dabit, on behalf of himself and other similarly situated current and former Merrill Lynch brokers, alleged claims for breaches of fiduciary

duty and the covenants of good faith and fair dealing implied in the brokers' employment contracts with Merrill Lynch. *Id.* Dabit sought damages in the nature of (1) lost commissions from clients who closed their Merrill Lynch accounts after suffering losses from investing in Merrill Lynch recommended securities, and (2) losses resulting from holding Merrill Lynch recommended securities in their personal accounts, as a result of Merrill Lynch's wrongful conduct. *Id.* The facts of this case and the allegations of the Amended Complaint are more fully set forth in the Opinion below, *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25 (2nd Cir. 2005); Petitioner's Appendix ("Pet. App.") at 1a-52a, and are incorporated herein by reference.

After the United States District Court for the Southern District of New York dismissed Respondent's claims as pre-empted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Respondent appealed.

B. The Opinion of the United States Court of Appeals for the Second Circuit

In a lengthy opinion, the United States Court of Appeals for the Second Circuit affirmed in part and vacated in part the judgment below and remanded for further proceedings consistent with its Opinion. *Dabit v. Merrill Lynch*, 395 F.3d 25, 28, 50-51 (2nd Cir. 2005). Specifically, the Court held:

> (i) the meaning of "in connection with" under SLUSA is coterminous with the meaning of the nearly identical language of §10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Pub. L. No. 73-291, 48 Stat. 881, 891 (1934) (codified at 15 U.S.C. §78j(b)) and its corresponding Rule

> 10b-5, 17 C.F.R. §240.10b-5, and (ii) the purchaser-seller rule of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), applies as a limit on SLUSA's "in connection with" requirement such that SLUSA does not pre-empt claims that do not allege purchases or sales made by the plaintiff or the alleged class members.

Id. at 28; Pet. App. at 3a-4a. More particularly, the Court affirmed the judgment below to the extent it found Dabit's "holding" claims pre-empted for the reason that they "satisf[ied] SLUSA's conditions requiring pre-emption because they contain implicit allegations of purchases made by plaintiffs and putative class members." *Id.* The Court, however, vacated "so much of the judgment as dismissed Dabit's lost-commission claim and dismissed the remaining claims with prejudice, and remand[ed] to the district court to dismiss these claims without prejudice so that plaintiffs may (if the pertinent facts warrant) bring new actions that do not include allegations of fraud 'in connection with the purchase or sale of a . . . security.'" *Id.* Petitioner seeks review only of the portion of the Second Circuit's Opinion holding that Respondent may avoid preemption by re-pleading his Complaint to exclude from the putative class, persons who purchased their securities holdings based on misrepresentations or omissions made by Merrill Lynch. Petition for a Writ of Certiorari at 10 n.4. Thus, the Second Circuit's holding that Dabit's claims for lost commissions are not pre-empted by SLUSA is not implicated by the Petition for a Writ of Certiorari.

In reaching its decision, the Court first determined that the judicial interpretation of "in connection with" the purchase or sale of a security under §10(b) and Rule 10b-5 applies in construing SLUSA. *Id.* at 35-36; Pet. App. at

19a-20a. The Court noted, however, that "the 'in connection with' phrase, while broad, is of course not unlimited." *Id.* at 37; Pet. App. at 23a.

> "[T]he incidental involvement of securities do[es] not implicate the anti-fraud provisions of the federal securities laws." The fraud must be integral to the purchase and sale of the securities in question. *Zandford*, the Supreme Court's most recent elaboration of the "in connection with" requirement, cautions that the phrase must not "be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation of §10(b)."

Id. (citations omitted) (quoting *SEC v. Zandford*, 535 U.S. 813, 820, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002)).

Next, the Court identified a second limitation on the question of whether a given fraud arises "in connection with the purchase or sale" of a security so as to give rise to a private action for damages under Rule 10b-5, i.e., the procedural limitation prescribed by the purchaser-seller rule in *Blue Chip Stamps*. *Dabit*, 395 F.3d at 37; Pet. App. at 23a.

The Court then concluded that the *Blue Chip Stamps* rule applied to the SLUSA analysis. *Dabit*, 395 F.3d at 39-44; Pet. App. at 26a-36a.

> Congress employed language with a settled judicial interpretation of which *Blue Chip* was a part and we see no clear indication either in the text or the legislative history of SLUSA of a congressional intent to abolish non-purchaser and non-seller state class action claims.
>
> . . .

> The limitation on standing to bring private suit for damages for fraud in connection with the purchase or sale of securities is unquestionably a distinct concept from the general statutory and regulatory prohibition on fraud in connection with the purchase or sale of securities. . . . That observation, however, has little persuasive force in this context, because SLUSA deals with precisely the category of actions subject to the purchaser/seller rule. Once it is agreed that Congress deliberately borrowed SLUSA's "in connection with" language from §10(b), the fact that the standing rule is analytically distinct from the underlying prohibition on fraud does not compel the conclusion that SLUSA preempts more than the purchaser/seller category of private damages claims over which the "in connection with" source language operates. Because *only* purchasers and sellers have a federal private damages remedy, it is far more natural to suppose that Congress meant to import the settled standing rule along with the "in connection with" phrase as a substantive standard. Nor are we moved by the observation that the standing rule is merely a judge-made gloss on the statute and the rule because private Rule 10b-5 damages actions are themselves a creature of judicial implication.

Id. at 39-40; Pet. App. at 28a (citations omitted). Moreover, the Court held, "[t]o the extent the legislative history casts any light on the question, it suggests that Congress intended to preempt only those state claims that had migrated from state to federal court in response to the PSLRA." *Id.* at 41; Pet. App. at 32a.

REASONS FOR DENYING THE PETITION

A. This Case is in an Interlocutory Posture

The Second Circuit affirmed in part, vacated in part and remanded this action to the district court. Petitioner seeks certiorari review of only that portion of the Second Circuit's opinion that reversed the district court's dismissal of Dabit's holding claims with prejudice and remanded with the directive that Dabit shall be allowed leave to amend to (if the pertinent facts warrant) allege "holding" claims that do not include allegations of fraud "in connection with the purchase or sale of a . . . security." Dabit's claims for lost clients and commissions are not challenged. Thus, regardless of the Supreme Court's disposition, this case is destined for further proceedings in the district court. Accordingly, this case is in an interlocutory posture.

The Supreme Court generally awaits final judgment in the lower courts before exercising its certiorari jurisdiction. *Virginia Military Institute v. United States*, 508 U.S. 946, 113 S.Ct. 2431, 2432, 124 L.Ed.2d 651 (1993).

> [C]ertiorari jurisdiction is "to be exercised sparingly, and only in cases of peculiar gravity and general importance, and in order to secure uniformity of decision. *** Thus, the lack of finality of the judgment below may 'of itself alone' furnish sufficient ground for denial of the application."

R. Stern, E. Gressman, S. Shapiro and K. Geller, *Supreme Court Practice*, §4.18 (8th Ed. 2002) (quoting *Hamilton Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258, 36 S.Ct. 269, 60 L.Ed. 629 (1916)). "[B]ecause the Court of Appeals remanded the case, it is not yet ripe for review

by this Court." *Brotherhood of Locomotive Firemen and Enginemen v. Bangor and Aroostook Railroad Co.*, 389 U.S. 327, 328, 88 S.Ct. 437, 19 L.Ed.2d 560 (1967) ("The Court of Appeals ruled on various legal issues presented to it but remanded to the District Court to consider whether there had in fact been a contempt, and, also, if there was a contempt, whether it was 'of such magnitude as to warrant retention, in part or to any extent, of the coercive fine originally provided for in contemplation of an outright refusal to obey.' ").

Moreover, it is possible that upon remand Respondent may be unsuccessful in pleading holding claims that are beyond SLUSA's reach. In such case, the question raised by Petitioner would likely be moot and review by the Supreme Court would not be implicated. The Supreme Court decides questions "in the context of meaningful litigation. Its function in resolving conflicts among the Court of Appeals is judicial, not simply administrative or managerial." *The Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180, 184, 79 S.Ct. 710, 3 L.Ed.2d 723 (1959). Moreover, the question raised by Petitioner can be presented when certiorari is later sought from the final judgment should such become necessary. Stern, *Supreme Court Practice* §4.18 at 260; *Virginia Military Institute*, 508 U.S. at 2431, 113 S.Ct. at 2432.

For these reasons the case is not certworthy.

B. The Purported Conflict Between the Circuits is False

Petitioner contends that the Court's holding in *Dabit* directly conflicts with the Seventh Circuit's holding in *Kirscher v. Putnam Funds Trust*, 403 F.3d 478 (7th Cir.

2005), *rehearing and rehearing en banc denied* (7th Cir. 2005). *Kirscher* was a case involving shareholders of mutual funds. The plaintiffs alleged that the funds' misconduct in setting prices had left the funds vulnerable to exploitation by arbitrageurs. The proposed class was defined as all investors who held the funds' securities during the defined period and neither purchased nor sold shares during that period. *Id.* at 483. The Seventh Circuit found that the plaintiffs' claims were preempted by SLUSA.

In its opinion, the Seventh Circuit pronounced that the *Blue Chip Stamps* purchaser-seller rule did not apply to the SLUSA analysis. However, the Court's ultimate holding and disposition of the case did not rest on this pronouncement. Instead, the Court held that "[p]laintiffs' claims are connected to their own purchases of securities and thus are blocked by SLUSA, whose pre-emptive effect is not confined to knocking out state-law claims by investors who have *winning* federal claims. . . ." *Kirscher*, 403 F3d at 484. In reaching this conclusion, the Court observed, among other things, that if the "funds had stated bluntly in their prospectus' (or otherwise disclosed to investors) that daily valuation left no-load funds exposed to short-swing trading strategies, that revelation would have squelched" the litigation. *Id.* at 484. The Court then observed:

> These observations show that plaintiffs' claims depend on statements made or omitted in connection with *their own* purchases of the funds' securities. They could have brought them directly under Rule 10b-5 in federal court (to the extent that the purchases occurred within the period of limitations). Indeed, most of the approximately 200 suits filed against mutual funds in the last two years alleging that the

> home-exchange-valuation rule can be exploited by arbitragers have been filed in federal court under rule 10b-5.

Id. at 484.

The purported conflict between the Second Circuit and the Seventh Circuit identified by Petitioner is a false one. This is so because the Seventh Circuit's pronouncement that the *Blue Chip Stamps* rule is not applicable to the SLUSA preemption analysis is nothing more than *obiter dicta*.

Black's Law Dictionary (Revised Fourth Edition) describes *dicta* as, among other things:

> Statements and comments in an opinion concerning some rule of law or legal proposition not necessarily involved nor essential to determination of the case in hand are *obiter dicta*, and lack the force of an adjudication.

Black's Law Dictionary defines "obiter dicta" as a statement "made during the course of delivering a judicial opinion, but one that is unnecessary to the decision in the case and therefore not precedential (though it may be considered persuasive)." *Best Life Assurance Co. v. Commissioner of Internal Revenue*, 281 F.3d 828, 834 (9th Cir. 2002) (quoting *Black's Law Dictionary* 1100 (7th Ed. 1999)).

Although the Seventh Circuit disagreed with the Second Circuit's determination that the *Blue Chip Stamps* purchaser/seller rule was a limitation on the preemptive reach of SLUSA, its resolution of the case did not rest upon this determination. Rather, the Seventh Circuit rested its decision on its determination that the alleged fraud occurred in connection with the plaintiffs' "own

purchases of securities." *Kirscher*, 403 F.3d at 484. In fact, the Court specifically stated that the plaintiffs could have brought their claims pursuant to Rule 10b-5.[1] *Id.* In other words, under the facts alleged as the Seventh Circuit found them, the *Kirscher* plaintiffs had *Blue Chip* standing to pursue remedies for Rule 10b-5 violations.[2] Thus, the Seventh Circuit's pronouncement concerning the inapplicability of the *Blue Chip Stamps* purchaser-seller rule to the SLUSA analysis was not necessary to its determination that plaintiffs' claims were preempted by SLUSA – it was *dicta*.

Panels of the United States Courts of Appeals are not bound by earlier panels' *dicta*. *Swann v. Southern Health Partners, Inc.*, 388 F.3d 834, 837 (11th Cir. 2004) (citing *Tagle v. Regan*, 643 F.2d 1058, 1064 (5th Cir. 1981); *Great Lakes Dredge and Dock Co. v. Miller*, 957 F.2d 1575, 1578 (11th Cir. 1992), *cert. denied*, 506 U.S. 981 (1992)); *Neal v. Roche*, 349 F.3d 1246, 1250 (10th Cir. 2003); *United States v. Burroughs*, 5 F.3d 192, 194 (6th Cir. 1993). Because the Seventh Circuit's pronouncement in *Kirscher* was mere dicta, subsequent panels of the Seventh Circuit, or even the same panel that decided *Kirscher*, do(es) not have to and may choose not to follow it. *See id.* Thus, the conflict among the Circuits as articulated by the Petitioner is a false one. There "must be a real or 'intolerable' conflict on

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[1] Also, though not specifically mentioned by the Seventh Circuit, among the proposed "holders" in *Kirscher*, there were undoubtedly individuals who were reinvesting dividends during the proposed class period. Such investors were, therefore, purchasers under the federal securities laws. *See Deutschman v. Beneficial Corp.*, 761 F.Supp. 1080, 1087 (D.Del. 1991).

[2] As characterized by the Seventh Circuit, such claims would have also been found to be preempted by the Second Circuit.

the same matter of law, not merely an inconsistency in dicta or in the general principles utilized." Stern, *Supreme Court Practice* §4.3 at 225.

Moreover, the Seventh Circuit is the only Circuit to reject the application of the *Blue Chip Stamps* rule to the SLUSA analysis. The other Circuits that have addressed the issue are in agreement that the *Blue Chip Stamps* analysis does apply. *See Kirscher*, 403 F.3d at 483. The D.C., First, Third, Fourth, Fifth, Sixth, and Tenth Circuits have yet to address the issue. Any decision by the Supreme Court on the issue should await the views of at least some of these Circuits.

Finally, although some Circuits, including the Second, have held that SLUSA related remand orders are not appealable, the Seventh Circuit will review such decisions.[3] Perhaps the issue could reach the Supreme Court through an Opinion issued by a subsequent Seventh Circuit Panel that either chose to follow or disregard the *Kirscher* Court's dicta.

For these reasons too, this case is not certworthy.

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[3] Just because a given Circuit does not hear appeals of SLUSA related remand orders does not mean the issue could not reach such Circuit for determination. The issue could reach the Circuit through a dismissal based on SLUSA preemption. It could also reach the Circuit through an action that originated in federal court. *Dabit* is just such a case. Also, numerous Circuits have yet to address the appealability of SLUSA related remand orders. These Circuits may follow the lead of the Seventh Circuit and find such orders are appealable. Moreover, the Seventh Circuit's determination that it had jurisdiction to consider the appeal of the district court's remand order itself creates a conflict among the Circuits, although not with the Second Circuit's holding in *Dabit*. This creates the unusual situation that the Seventh Circuit may have in fact lacked jurisdiction to make the ruling that Petitioner relies on for the purported conflict in this case.

C. The Second Circuit's Interpretation of SLUSA is Correct and Consistent with the Purpose of the Statute

In deciding the scope of SLUSA preemption, the Second Circuit started with the "assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Dabit v. Merrill Lynch*, 395 F.3d at 41; Pet. App. at 30a-31a (quoting *City of Milwaukee v. Illinois*, 451 U.S. 304, 316, 101 S.Ct. 1784, 68 L.Ed.2d 114 (1981)). A federal statute will not be regarded as completely preemptive of state law absent some express statement or other clear manifestation from Congress. *Id.* (citing *Marcus v. AT&T Corp.*, 138 F.3d 46, 54 (2nd Cir. 1998) (citing *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 65-68, 107 S.Ct. 1542, 95 L.Ed.2d 55 (1987))).

After determining that SLUSA does not anywhere define the phrase "in connection with the purchase or sale of a covered security," *Dabit v. Merrill Lynch*, 395 F.3d at 34; Pet. App. at 17a, the Court reviewed and discussed extensively the legislative history of SLUSA. The Court noted:

> "SLUSA comports with Congress's stated goal in enacting SLUSA of closing the 'federal flight loophole' by stemming the migration of claims from federal to state court. *See* SLUSA §2, 112 Stat. at 3227 (finding that "a number of securities class action lawsuits have shifted from Federal to State courts" and reciting that SLUSA aims to "prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA]"). *Accord Lander* 251 F.3d at 107-08. If the "in connection with" phrase is read to reach the same

> conduct under SLUSA as it does under §10(b) and Rule 10b-5, then SLUSA will preempt precisely those state class actions which could be brought as federal actions subject to the heightened requirements of the PSLRA.

Id.[4] at 36; Pet. App. at 21a.

The Second Circuit's conclusions are supported by the comments of Senator Christopher J. Dodd, one of the two principal sponsors of SLUSA. As the Second Circuit pointed out, Senator Dodd stated that SLUSA "if enacted, will allow Congress to address this state litigation problem . . . preempting only those class actions that have recently migrated to state court, while leaving traditional state court actions and procedures solidly in place." *Id.* at 42; Pet. App. at 32a-33a. Senator Dodd further explained that "[t]his legislation has been carefully crafted only to affect those types of class actions that are appropriately heard on the federal level." 143 Cong. Record §10475-01, 1997 WL 614735. Pure "holding" claims simply do not meet this criteria. Pure "holding" claims are not actionable under rule 10b-5[5] and have never been subject to the requirements of the PSLRA. *See Blue Chips Stamps*, 421 U.S. 723.

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[4] The Second Circuit in *Lander v. Hartford Life & Annuity Insurance Co.*, 251 F.3d 101, 110 (2nd Cir. 2001), previously observed that "both the statutory findings and the accompanying conference report make it clear that SLUSA targeted class action litigation intended to be reached by the PSLRA, which evaded the procedural requirements of the PSLRA by migrating to state court."

[5] The *Blue Chip Stamps* Court noted that the disadvantage imposed on Plaintiffs by not being able to seek remedies for such claims under Rule 10b-5 is "alleviated to the extent that remedies are available to purchasers and nonsellers under state law." *Id.* at 738 n.9, 95 S.Ct. 1917.

The Seventh Circuit's reasoning and the SEC's and Petitioner's argument that Merrill Lynch's conduct could give rise to civil enforcement actions by the SEC or criminal prosecutions and therefore is subject to SLUSA preemption misses the mark. SLUSA was enacted to address concerns that private litigants asserting private rights of actions for damages were skirting the heightened pleading standards imposed on Rule 10b-5 plaintiffs by the PSLRA. *Dabit v. Merrill Lynch*, 395 F.3d at 39-40; Pet. App. at 28a.

Petitioner's, the SEC's and Amicus' argument that the other elements necessary for maintenance of a successful action for damages under Rule 10b-5 should not limit the Court's construction of "in connection with" under SLUSA and therefore, it is improper to apply the standing rule applicable to such claims as a limit on SLUSA preemption also misses the mark. As stated by the Second Circuit:

> We need not and do not reach the question, but see no contradiction in concluding that Congress could have intended to pre-empt state law securities fraud actions that if brought under federal law would fail for proof of loss causation or lack of timely filing, but did not intend to pre-empt a category of actions that, because of the nature of the injury alleged, could never have constituted a potential federal action.

Id. at 43; Pet. App. at 35a.

Equally unavailing is the Seventh Circuit's reasoning and Petitioner's argument that because SLUSA aimed to shore up the PLSRA's remedial goal of curbing meritless strike suits, it would be anomalous for Congress to intend to carry over the purchaser-seller rule as a limiting construction of the "in connection with" language, because the

effect would be to permit the very category of claims that the Supreme Court identified in *Blue Chip* as posing a particularly high risk of vexatious litigation. As the Second Circuit aptly noted:

> The question in interpreting ambiguous statutory language . . . is not what Congress might sensibly want to do, but what Congress did.

Id. at 40; Pet. App. at 29a.

In short, the legislative history of SLUSA, and the statute itself "suggest that Congress intended to preempt only those state claims that had migrated from federal court in response to the PSLRA," *see id.* at 41-42 and n.10, and the Second Circuit's holding was correct.[6]

> Congress certainly understood that Rule 10b-5's "in connection with the purchase or sale" language had been interpreted for nearly a half century as limiting standing to transacting plaintiffs. Nonetheless, Congress replicated the same language in SLUSA, with no mention of any intent to extend its meaning to encompass claims brought by non-transacting individuals. This backdrop provides strong evidence that Congress did not intend to preempt holding claims.
>
> If the survival of holding claims serves to undermine the Reform Act in an intolerable way,

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[6] In reaching its decision, the Court gave only limited deference to the SEC's opinions concerning the application of SLUSA because "[t]he preemptive provisions of SLUSA, . . . unlike the parallel provisions of §10(b), do not create powers in the SEC or vest the SEC with any rule making, adjucative or other enforcement or interpretative responsibility. *Dabit v. Merrill Lynch*, 395 F.3d at 34 n.6; Pet. App. at 17a-18a.

> Congress can respond, much as it did with the passage of SLUSA itself and correct the oversight.

A. Rose, *Life After SLUSA; What Is the Fate of Holding Claims?*, 69 Def. Couns. J. 455, 460 (2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 598 (8th Cir. 2002).

For these reasons, too, the case is not certworthy.

CONCLUSION

For the reasons set forth herein, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

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Statutes:

Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 ("SLUSA") .....*passim*

15 U.S.C. 78j(b)). .....*passim*

Other Authorities:

Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991) 6

Respondent does not dispute that the question presented in the petition for certiorari involves an important issue of federal statutory law. Instead, he contends that certiorari should not be granted because: (i) there is no circuit conflict insofar as the Seventh Circuit's contrary holding is mere *dictum*; (ii) review is sought in an interlocutory posture; and (iii) the Second Circuit's holding below that state law claims brought by "holders" of securities are not preempted by the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 ("SLUSA") is consistent with the legislative purpose of that federal act.

None of the respondent's contentions refutes or undermines the arguments why certiorari is warranted. First, there is a direct and deep circuit conflict on the question presented in this petition. Respondent's assertion that the Seventh Circuit's contrary holding is mere *dictum* is incorrect. Judge Easterbrook explicitly stated that because of the nature of the allegations before it, the court had to answer the central legal question concerning the scope of SLUSA's preemptive effect (which is identical to the question presented in this case) and could not "postpone its resolution." *Kircher v. Putnam Funds Trust*, 403 F.3d 478, 483 (7th Cir.) (Easterbrook, J.), *rehearing denied*, No. 04-1495, 2005 U.S. App. LEXIS 7914 (7th Cir. May 2, 2005). (*See* pp. 2-5, *infra*.)

Second, interlocutory review is the only effective way to address meaningfully the issue presented in this case and to further the purpose of the statute at issue here. This Court on numerous occasions has granted certiorari in securities cases such as this, where the court of appeals had reversed summary judgment or dismissal of the complaint and remanded for further proceedings. (*See* pp. 5-8, *infra*.)

Third, the decision below is inconsistent with SLUSA's plain language, which contains no "purchaser-seller" limit to the scope of preempted claims it sets forth. If the decision below is allowed to stand, SLUSA will necessarily fail in its purpose to establish uniform national standards for securities litigation. "Holding" claims have been disallowed in federal private securities actions by the judicially crafted purchaser-seller standing requirement precisely because federal courts

have determined that the potential for private abuse of such claims is disproportionately great. Yet to allow such claims to be brought under state law – in circumstances where national and international companies such as petitioner will be exposed to class action litigation under multiple state procedural and substantive standards, complicated enormously by difficult choice of law questions regarding the application of different states' laws to different members of the nationwide classes – directly contravenes the language and purpose of SLUSA to establish uniformity and to promote efficiency in the national securities markets. (*See* pp. 8-10, *infra*.)

1. The Rule Announced by the Seventh Circuit in *Kircher* Is Not Mere *Dictum*

Respondent contends that "under the facts alleged as the Seventh Circuit found them, the *Kirscher* [*sic*] plaintiffs had *Blue Chip* standing to pursue remedies for Rule 10b-5 violations." (Respondent's Brief in Opposition, at 10 (hereafter "Resp. Br.").) Accordingly, he asserts that the Seventh Circuit's rule – that state law claims which are preempted under SLUSA include pure "holding" claims, and are not limited to those which satisfy the purchaser-seller requirement under *Blue Chip Stamps* for viable private federal securities claims[1] – is mere *dictum*.

But the putative class as defined in the complaint considered in *Kircher* did *not* have *Blue Chip* standing to assert federal securities claims under section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)). The Seventh Circuit expressly stated that "[the purchaser-seller rule of] *Blue Chip Stamps* would prevent such a private action from proceeding under Rule 10b-5," noting that one of the complaints at issue "define[d] the class as all investors who held the fund's securities during a defined period *and* neither purchased nor sold shares during that period." *Kircher*, 403 F.3d at 483. As respondent himself incongruously recognizes, "[t]he proposed class [in *Kircher*] was defined as all investors who held the fund's securities during the defined period and *neither*

[1] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

purchased nor sold shares during that period." (Resp. Br. at 8 (citing *Kircher*, 403 F.3d at 483).)

Because the class at issue in *Kircher* did not include purchasers or sellers of the securities during the defined period, it was necessary for the Seventh Circuit to decide the central legal issue, also presented in this petition: whether under SLUSA "holding" claims that cannot be brought under the federal securities laws for failure to satisfy the purchaser-seller standing requirement of *Blue Chip Stamps* may nevertheless be brought under state law.

In considering this issue, Judge Easterbrook described the varying views of other courts of appeals on the issue of SLUSA preemption of state law holding claims:

> An equation between SLUSA's coverage and the scope of private damages actions under Rule 10b-5 has the support of the second circuit (*Dabit*), the eighth circuit (*Green*), and the eleventh circuit (*Riley*). The ninth circuit (*Falkowski*), by contrast, has written that coverage of SLUSA tracks the coverage of § 10(b) and Rule 10b-5 when enforced by *public* plaintiffs (the SEC or a criminal prosecutor). The third circuit (*Rowinski*) has reserved decision on this issue. The Securities and Exchange Commission filed a brief in *Dabit* as amicus curiae supporting the view that SLUSA tracks the full scope of § 10(b) and Rule 10b-5, not just their enforcement in private actions.

Kircher, 403 F.3d at 483. He then went on to consider, and specifically reject, that resolution of this issue on which the courts of appeals had grappled could be avoided in deciding the case: "The way the *Spurgeon* class has been defined prevents us from following the third circuit's path: **we must answer the question rather than postpone its resolution**." *Id.* (emphasis added).

Turning to the merits of the question, the Seventh Circuit reviewed the plain language of SLUSA as well as the policies underlying both SLUSA and the purchaser-seller rule. It concluded, in direct conflict with the decision below: "We hold that SLUSA is as broad as § 10(b) itself and that limitations on private rights of action to enforce § 10(b) and

Rule 10b-5" do not apply to SLUSA's "in connection with the purchase or sale" language and therefore the exclusion of purchasers or sellers from a plaintiff's putative class does not avoid preemption. *Id.* at 484.[2]

In the course of rendering this holding, Judge Easterbrook observed in passing that the *Kircher* plaintiffs' state law class action claims and the putative class period *could* have been redefined so as to constitute federal securities law claims based on misrepresentations or omissions in connection with their securities purchases. He observed that at least some part of the *Kircher* class plaintiffs *would* have had *Blue Chip* standing under the federal securities laws *had they defined their putative class differently and pled their claims differently, i.e.*, had they not attempted to define a class without purchasers or sellers. *See Kircher*, 403 F.3d at 484. But they did not so plead and so, as Judge Easterbrook explicitly stated, resolution of the issue presented in this petition was necessary to the Seventh Circuit's disposition of the class allegations in *Kircher*. *See id.* at 483.[3]

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[2] Between the time of the issuance of the Seventh Circuit's mandate in *Kircher* and the dismissal by the district court, several of the plaintiffs sought to amend their complaints to withstand preemption. These efforts were denied. *See, e.g., Spurgeon v. Pacific Life Ins. Co.*, No. 04-cv-0355-MJR (slip op.) (S.D. Ill. May 27, 2005).

[3] The Seventh Circuit's observation concerning plaintiffs' ability to have pled their claims differently simply illustrated Judge Easterbrook's conclusion that plaintiffs in that case had manipulated their claims to avoid federal jurisdiction:

> Our plaintiffs' effort to define non-purchaser-non-seller classes is designed to evade PSLRA in order to litigate a securities class action in state court in the hope that a local judge or jury may produce an idiosyncratic award. It is the very sort of maneuver that SLUSA is designed to prevent.

Id. at 484. The same can be said of respondent's allegations in this case. Respondent has defined an arbitrary "holding" class period beginning on December 1, 1999. In the related federal securities fraud cases based on the same alleged conduct and involving many of the same securities, the putative class periods often begin earlier than December 1, 1999. For example, the putative class period for the section 10(b) claim relating to purchases of Internet Capital – securities Dabit asserts he was injured from holding – begins four months before Dabit's "holding" period, *i.e.*, on August 5, 1999.

In their petition seeking *en banc* rehearing, the *Kircher* plaintiffs affirmed unequivocally that the question presented herein was in fact decided by the Seventh Circuit, in deep and direct conflict with other courts of appeals:

> These eight consolidated cases present questions of exceptional importance (and of first impression) because the panel's decision conflicts with the decisions of the Second, Eighth, Ninth and Eleventh Circuits. Three of those circuits have held that the Securities Litigation Uniform Standards Act (SLUSA) does not preempt state law claims in connection with the retention of securities but rather, as the statutory language expressly provides, preempts only class action securities fraud claims "in connection with the purchase or sale of a covered security." As the Second Circuit noted, "this holding aligns us with every circuit court that has considered the question thus far." The *Kircher* panel is the only court to rule otherwise.

(*Kircher* Appellees' Petition for Rehearing En Banc at 1 (citations omitted) (quoting *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 43 (2d Cir. 2005); citing *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334 (11th Cir. 2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590 (8th Cir. 2002)).)[4] Respondent's assertion that the Seventh Circuit's ruling was mere *dictum* is thus incorrect and the deep and direct conflict between the courts of appeals on the important issue presented in this petition cannot be refuted.

2. The Question Presented Is Ripe for Review by this Court and May Be Effectively Unreviewable at a Later Stage

Respondent cites the interlocutory posture of this case as a reason why the Court should not review the issue presented. A requirement of a final judgment from the district court and a second appeal, however, would almost certainly *prevent* any effective review by this Court in light of the nature of the case.

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[4] The *Kircher* Appellees' petition for rehearing was denied on May 2, 2005. *Kircher v. Putnam Funds Trust*, No. 04-1495, 2005 U.S. App. LEXIS 7914 (7th Cir. May 2, 2005).

On numerous occasions in similar circumstances, this Court has granted certiorari in securities cases such as this, where the court of appeals had reversed and remanded for further proceedings following dismissal of the complaint or a grant of summary judgment. The issue in this case now presents compelling reasons for interlocutory review.

Were it necessary to resolve all of the issues in the district court and await final judgment in respondent's case, there would likely not be any opportunity for meaningful review of the question presented. As this Court described at length in *Blue Chip Stamps*, the *in terrorem* effect of securities class action litigation often forces settlements out of proportion to the merits of the case, both because of the burden of the broad discovery sought in such cases, and because of the risk, however small, of a potentially bankrupting judgment. *See, e.g.*, 421 U.S. at 740-41 ("[E]ven a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long has he may prevent the suit from being resolved against him by dismissal or summary judgment."). A case such as respondent's here – alleging claims involving 48 different securities and with the proof of such claims depending "almost entirely on oral testimony," *id.* at 743 – is just the sort of case the *Blue Chip Stamps* Court found particularly unlikely to go to final judgment. *See id.* at 740-43.[5]

In explicit recognition of the disproportionate costs and dangers to defendants of allowing meritorious as well as unmeritorious class action suits to proceed to discovery, the statutory framework of SLUSA provides – and was expressly intended to provide – the means for the immediate removal

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[5] This same concern has been cited by courts of appeals when granting discretionary interlocutory review. The Second, Third and Seventh Circuits, for example, have explained that due to the "'hydraulic pressure on defendants to settle, avoiding the risk, however small, of potentially ruinous liability'" once a class has been certified "very few securities class actions are litigated to conclusion." *Hevesi v. Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2004) (quoting *Newton v. Merrill Lynch*, 259 F.3d 154, 164 (3d Cir. 2001) and *West v. Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) (Easterbrook, J.) (citations omitted)); *see also* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991).

and dismissal of state law claims alleging misrepresentations or omissions or deceptive devices or contrivances in connection with the purchase or sale of securities. If this Court were to deny review based simply upon the interlocutory posture of this case, thereby requiring the fulsome litigation of respondent's claims to their conclusion prior to full legal review of their sufficiency, SLUSA's express purpose would be frustrated.

Indeed, in light of the unlikelihood of a final judgment on the merits in the securities context, this Court regularly reviews federal securities law cases in an interlocutory posture. Most recently, the Court granted review in *Dura Pharmaceuticals, Inc. v. Broudo*, 124 S. Ct. 2904 (2004), despite the fact that the action was in an interlocutory posture and there would be further proceedings in the district court regardless of how this Court ruled. In *Dura*, the loss causation issue on which the petitioner sought and successfully obtained review related to only one of the alleged misstatements in the case, *see Dura Pharms., Inc. v. Broudo*, 125 S. Ct. 1627, 1629-30 (2005), although in the opinion below, the Ninth Circuit had granted plaintiffs leave to amend to address various other pleading defects. *See Broudo v. Dura Pharms., Inc.*, 339 F.3d 933, 940-41 (9th Cir. 2003), *rev'd on other grounds*, 125 S. Ct. 1627 (2005).

Similarly, this Court has granted interlocutory review in several other securities law cases, notably in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (aiding and abetting liability); *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991) (statute of limitations); *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (materiality and reliance); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (breach of fiduciary duty); and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (scienter).

Interlocutory review is especially warranted in this case, because the courts of appeals will be unable to resolve the conflict absent a decision by this Court. State law claims brought within those circuits which have held that such claims are not preempted by SLUSA will be subject to remand orders to state court. But three of those courts of appeals - including the Second Circuit - have held that they have no appellate